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From:

Sent: Wednesday, July 08, 2009 11:15:00 AM

To:

Cc:

Subject: PR vs Federal Law for Settlement Income

Greetings

I don't know much about Act 80, but in reading these e-mails I get the impression that the following statement in Pub 957 is the source of the problems you are raising:

"Back pay awards, under some of the statutes listed above, may be compensation for personal injury and not pay for employment. Such awards are not wages for social security coverage purposes."

I think the statement above is referring to payments that are excludable from income under section 104(a)(2) of the Internal Revenue Code. Payments received on account of personal physical injuries or physical sickness are excludable from income under section 104(a)(2). If the settlement payments are excludable from income under section 104(a)(2), then they are not wages subject to employment tax.

In order to be excludable from income under section 104(a)(2), payments must be made in settlement of a claim based on tort or tort-type rights, and the taxpayer must show that the damages were received on account of personal physical injuries or physical sickness.

Damages recovered from an employment-related dispute generally are not recoveries for a personal physical injury. Thus, employment-related judgment/settlement amounts will generally be included in the employee's gross income. Therefore, the most difficult questions usually are whether the amounts are wages for employment tax purposes, and the proper reporting of the amount (Form 1099, or Form W-2, and reporting of attorneys' fees on Form 1099).

Again, I know very little about Act 80 but I do know that, under US federal tax law, simply calling a payment "personal damages" is not enough to make that payment excludable from income and from wages. You need to figure out whether the payment would be excludable from income under section 104(a)(2). In order to figure that out, you need to determine whether there is a personal physical injury or physical sickness. Emotional distress is not considered a physical injury or sickness, but if there is actual medical treatment for emotional distress, reimbursements for the cost of the medical treatment can be excludable under section 104(a)(2). I hope this is helpful.